Audit's® NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

February 11, 1977 VOL. VIII, No. 3

INVESTMENT SELECTION AND REVIEW ISSUE

Share amounts of trusts reviewed in this issue

Trust	Traded	Bk.Val.	Price	Ann.Div.	Ann.Yld.	%/Bk	Page
Baird & Warner Mtg...	OTC	$16.67	$ 7.25	$0.96	13.2%	-56%	8
CleveTrust Realty....	OTC	11.03	3.38	Nil	Nil	-69	3
First Cont. REIT.....	OTC	10.26	8.38	0.88	10.5	-18	5
Lomas & Net. Mtg.....	NYSE	31.61	15.75	0.84	5.3	-50	2
M&T Mtg. Investors...	OTC	10.25	9.38	1.04	11.1	- 8	5
Property Tr. Amer....	OTC	7.72	4.13	0.20	4.8	-47	7

INVESTMENT SELECTION: SIX RECOVERY CANDIDATES ATTRACTIVE BECAUSE THEY TENDED KNITTING

The six recovery candidates reviewed this issue are recovery candidates for two basic reasons: 1) they tended their knitting and stayed with properties and small geographic areas they knew best, and 2) as a result, they didn't become pregnant with overblown debt. Leverage ratios of all debt to shareholders' equity are uniformly low, and the trust with the highest debt/equity ratio, CleveTrust Realty at 2.8-to-1, also has the longest recovery road ahead by a wide margin.

This business of tending one's knitting is a sensitive issue because Wall Street's alleged experts have promulgated so much nonsense on this count that many investors are understandably confused. But real estate is a local business and the trust serviced by a field staff that can drive by its properties every week or so is miles ahead -- both literally and figuratively -- of the REIT staff that has to jet from Hawaii to Maine to inspect holdings. Thus M&T Mortgage stayed home and worked the business it knew best and was staffed to handle, single family mortgage lending in Texas. Likewise First Continental, Lomas & Nettleton, and Baird & Warner all confined activities to local geographic areas and maintained dividends through the real estate recession. Wall Street may be turned off by the small size and OTC markets, but investors can find stable and even generous yields.

TRUST NOTES: State Mutual Investors plans offering 72½% of par for its 9% senior subordinated notes due 1980. A recently formed noteholders' committee has approved the offer, which must be accepted by 85% of holders...The expected flood of warrant expirations has begun, as indicated in Jan. 28 RTR. IDS Realty warrants expired Feb. 1, and Central Mtg. and Hospital Mtg. will let warrants die March 25 and Feb. 16 respectively. Hospital thus reversed an earlier "intent" to extend for one year.

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GROUP RATES ON REQUEST

LOMAS & NETTLETON MORTGAGE INVESTORS (16--NYSE--LOM) FY June 30

Real estate investments: This large short-term mortgage trust has voluntarily limited commitments since spring of 1974 with the result that total funded investments have fallen over 42% from a peak $397 million in March 1974. Investments now total $228.4 million and some rebuilding of funded loans is expected near-term as the trust made $149.6 million new commitments in the June 1976 fiscal year and another $45 million in the six months to Dec. 1976. Unfunded commitments are $67 million. Current investments are 74% mortgage loans, 24% property acquired in foreclosure and held by a related entity, and 2% long-term lease rentals. Mortgage loans are further broken down as first mortgage construction loans, 26% of the total portfolio; land acquisition and development loans, most for single family and apartment use, 30%; second mortgages, 8%; other mortgages, 8%; and conventional permanent loans, 1½%. This is a fairly aggressive mix, with highest risk in the land acquisition/development and second mortgage categories. Most new loans are on small residential tracts in active housing markets, however. Standard income property types have been stressed generally, although about 7½% are single-family construction loans. The trust has specialized in Texas, where 50% of investments are located; other major concentrations are in Sunbelt states: Colorado, 8%; Florida, 7%; Georgia and Arizona, 6% each.

Trust investments maintained fairly good liquidity during the 1974-5 real estate recession because LOM stuck with smaller residential deals and took no large exposure to condos or recreational property. During fiscal 1976, about 69% of beginning balances of construction loans was repaid, up from a 56% payback ratio the prior year. These payback ratios are among the highest for construction mortgage trusts. All investments were liquidated in about 10½ months during FY 1976.

A total of $71.8 million investments, or 31.5%, is classed as mortgages not earning income or foreclosed property; this percentage has been holding in the 30% range in recent quarters after peaking at 37.7% in the March 1976 quarter. Since the total of investments is also falling, the percentage decline bespeaks management ability to move aggressively to dispose of foreclosed properties faster than sound loans are repaid. At the end of FY 1976 the trust and Lomas & Nettleton Financial Corp., trust adviser, formed L&N Consultants, Inc., to hold, complete, manage and market foreclosed properties. The trust owns 80% of this entity because the trust and its adviser had participated on an 80-20% basis on substantially all trust investments; the joint company simplifies administration of acquired properties. During FY 1976, the trust sold $20.5 million of acquired property and provided first mortgage financing on another $15.9 million conveyed to other borrowers; the $36.4 million total is among the industry's largest disposition volumes and was well ahead of the prior year's $8.1 million. Another $18.1 million was liquidated in the six months to December 1976. The trust's disposition record and its ability to hold nonearning loans at relatively low levels reflect concentration of investments in Texas, where housing markets have been strong because of petroleum-related activities.

Financing: All debt is 1.1 times shareholders' equity, an extremely conservative leverage ratio for a short-term construction mortgage trust but in keeping with the real estate cycle. Total debt has been liquidated quite rapidly since peaking at $288 million in the March 1974 quarter, the total decline now amounting to over 50% of peak debt. The debt paydown coincides with trust policy to constrict new investment commitments voluntarily since early 1974. Commercial paper sales were discontinued after the September 1975 quarter when the trust's commercial paper rating was withdrawn by mutual agreement with rating agencies. Short-term borrowings are under specific agreements for fixed lines of credit aggregating $183 million currently. The agreements restrict pledging of assets and the extent and nature of additional borrowings. Interest is at the prime rate and compensating balances (mostly provided by the sponsor) generally are 10% of the line and 10% of amounts used.

In January 1977 LOM refinanced a $21 million long-term note by borrowing $35 million for 3½ years from 13 institutions. Interest is at 110% of the prime rate.

The other long-term notes for $75 million are due in $7.5 million installments on May 15, 1977 and 1978, and $30 million on May 15, 1979 and 1980. The notes bear interest at 120% of the prime rate through the 1978 payment date, when the rate moves up to 122% of the prime. The trust is required to maintain $100 million net worth under this agreement.

Management & REIT status: LOM is advised by L&N Management, Inc., subsidiary of Lomas & Nettleton Financial Corp., nation's largest mortgage banker with over $5 billion mortgages serviced for distant investors. The adviser receives a fee based upon a percentage of assets subject to various limitations; during FY 1976, the advisory fee became limited to, among other things, 25% of net income before the fee but after provision for losses; the loss provision had been excluded previously. As a result the adviser refunded $855,000 to the trust in the June 1976 quarter, equal to 23¢/share. The adviser participates 20% in all trust investments. The trust was organized in July 1969 and has maintained REIT status continuously.

Results & outlook: Earnings have recovered to 21¢/sh. in the December quarter from a low of 9¢/sh. Management acknowledges being about two quarters behing its recovery schedule, so expectations are for not much change in earnings the next two quarters. But recovery should be more apparent beginning about Sept. this year. The trust has maintained continuous dividends by a conservative financing posture of very low leverage, and by concentrating on residential properties in Texas areas it knows best. Management has had good success in disposing of problem properties, thereby keeping total problems at low levels. We can visualize quarterly earnings at a $1.60-$1.80/sh. annual rate in the first half of 1978, but shares may not sell much above $20. The shares are thus attractive for stable and rising income. (KDC)

CLEVETRUST REALTY INVESTORS (3 3/8--OTC-CTRIS) FY Sept. 30

Real estate investments: Investments peaked at $131 million in mid-1974 and current holdings of $113.3 million are a combination of $17 million long-term mortgages, or 15% of holdings; short-term construction loans of $36.5 million, or 29% of holdings; equity investments in property of $17.7 million or 17%; and real estate acquired in foreclosure of $45.4 million or 40%. By property type, investments are 27% apartments, 17% office buildings, 18% land and land loans, 24% commercial and industrial (mainly shopping centers, motels and warehouses), and 5% condominium. Investments are 26% in Texas, 15% Ohio, 13% Illinois, 9% Colorado, and 6% Florida.

A total $51.2 million investments, or 45%, are classed as not earning income, and another $19.7 million, or 26%, are classed as partially earning because they earn less than 7% on investment. The 71% total is above average for long-term mortgage trusts at this time in the real estate cycle. These investments are not total losses but hurt by depressed real estate markets. Short-term construction and land loans have provided most troubles and are 80% nonearning. Long-term mortgages are now all current, although some have been foreclosed, and 73% of $8.8 million in second mortgages is also not earning income.

Property operations, including both investments and foreclosures, provided $372,000 net income before overhead and general interest in FY 1976, on average cash investment of $36½ million during the year. Net cash investment was $44.5 million at year-end. These properties operated at a $1.5 million cash flow surplus for the year, about a 5.2% cash on cash return on operating properties. Since results from investment properties and foreclosures aren't stated separately, it's not possible to be certain about profit contributions of the two major ownership groups. The bulk of deliberately acquired property at Sept. 1976 was $14.6 million gross invested in five office buildings with 445,000 sf that was 98% occupied at that date.

While the equity investments provide the base for long-term earnings, speed of the trust's recovery will depend heavily upon ability to turn around and either dispose of or re-mortgage properties already acquired or to be acquired through foreclosure. This $45.5 million of acquired property at Sept. 30, 1976 was 52% in apartments, 23% in commercial/industrial, 19% in land, 4% condominiums, and 3%

office. CleveTrust has acquired seven apartment complexes with 1,818 dwelling units with a total $23.6 million investment; they were reported 91% occupied at Sept. 30, 1976. In December 1976 the trust borrowed $5 million of a $5.65 million first mortgage commitment for 357-unit Towers of Schaumburg, Schaumburg, Ill., where it has $7.25 million invested. Commercial properties acquired include $3.0 million in a 197-room motel in St. Louis; $2.65 million in a 133,000 sf office/warehouse in Dallas; $1.5 million as 12% interest in the 824-room Court of Flags motel in Orlando, Fla.; $1.4 million in a 99,000 sf shopping center in Edinboro, Pa.; and $1.25 million in a 99,000 sf strip shopping center with warehouse in Hilton Head, S.C. Three major land parcels held include $1.9 million in 35 partially developed acres, zoned mainly for high-density apartments in Schaumburg, Ill., near the apartments owned; $1.9 million in 285 undeveloped acres, zoned mainly for multi-family residential in Northhampton, O. (near Akron); and $3.2 million on 28 undeveloped acres in Bayside, Queens, N.Y. now zoned industrial but expected to be rezoned to apartment and residential uses. In December 1976 the trust acquired in foreclosure an additional $5.0 million of land in the Dallas, Tex. area. During fiscal 1976 the trust sold its 228-unit Los Arbolitas apartment complex in Thousand Oaks, Cal. to an unrelated buyer who took over an existing first mortgage. The trust says $20.0 million of properties are held for sale or development, but aside from land parcels, won't identify specific properties for sale. Management says it wants out on any sales and won't take back any purchase money mortages or other paper.

Financing: Total debt is 2.8 times shareholders' equity and 2.1 times combined equity and loss reserves, both ratios considered good at this stage of the real estate cycle. Debt structure is relatively simple, debt consisting only of mortgage debt on property and borrowings under a credit agreement with 12 banks. The trust signed a $63.8 million credit agreement with its banks March 23, 1976, retroactive to Jan. 1, 1976, maturing Dec. 31, 1977 but extendable for 12 months provided debt reduction and other conditions are met. Contingent interest calculated at 130% of the prime rate amounted to $747,000 at Sept. 1976 but this amount was not accrued, indicating management's doubt that it will ever be paid.

Principal payments of $6 million each year are required during each year of the agreement on the $51.8 million base loan agreement. The trust must pay 7% interest on the remaining $12 million Series B term loan, which is non-amortizing. The trust paid $11.8 million on the base loan through Dec. 27, 1976, thus satisfying nearly all the $12 million principal reduction required through calendar 1977, and reducing bank debt to $52 million on that date. Cleveland Trust Co., principal bank subsidiary of the sponsoring bank holding company, provides about $22.95 million, or 36%, of this total credit, including all the Series B term loan.

Management & REIT status: CleveTrust Advisers, Inc., is a subsidiary of Cleveland Trust Co., major Cleveland bank, and receives a percentage of assets subject to certain limits. The trust did not qualify as a REIT in FY 1976. The trust had $6 million net taxable operating losses available as a carryforward at end of FY 1975; the additional taxable loss for FY 1976 has not yet been determined.

Results & Outlook: The December quarter loss of 18¢/sh. was in line with operating losses in recent quarters, although the September quarter was in the black by 15¢/sh. after a 25¢/sh. gain on sale of a California apartment. The trust is in good strategic position for a longer-term recovery, with bank debt of $52 million converting to mortgage debt over 3-5 years as completed properties, both acquired voluntarily or by foreclosure, become more productive than the current 5% cash return. Land acquired in foreclosure now stands at $13 million and will delay any rapid turnaround. Presence of a strong bank sponsor should help financially. The management record in buying properties at retail and managing them profitably is not outstanding however. Thus the shares are recommended now only as speculative recovery candidates toward the $11/sh. book value as problem properties are cured. (KDC)

FIRST CONTINENTAL REAL ESTATE INVESTMENT TRUST (8¼--OTC--FCRES) FY Feb. 28/9

Real estate investments: Total investments peaked at $47 million in November 1974 and then declined to $35 million in February 1976 as management reduced commitment and lending volume during the recession. New commitments are now being made selectively and funded loans have rebounded to $45 million, providing a base of earning assets to sustain earnings. Investments now are 45% construction loans, 42% land development loans, 5% land acquisition loans, 1% junior mortgages, and 7% property acquired in foreclosure. By property type, 22% are single-family construction loans, 1% apartment construction loans, 18% shopping center construction, 3% office building construction, 28% development loans for commercial properties, and 19% development loans for residential properties. About 87% of investments are in Texas, 9% near Tulsa, Okla., where a subsidiary of the sponsor operates and 3% in Colorado. The loan mix is approximately half residential and half commercial and office, with management saying it intends to maintain this mix despite strong residential markets currently. Funded investments are likely to remain in the $40-$50 million range for some time.

Non-earning and foreclosed investments have been trending downward since peaking at $7.1 million, or 18.7% of the total, in November 1975 and now amount to $4.87 million, or 10.8%. Property acquired in foreclosure totals $3.1 million and includes $998,000 in a land tract in the fashionable Memorial Drive area of Houston where an out-of-town builder went broke and resale is expected within one year; $594,000 in a 58-acre tract north of Houston's jetport expected to be picked up by a substantial local developer; $979,000 in 37 acres in Lewisville, north of Dallas, taken in a deficiency judgment and scheduled to be served by a new local road; and $435,000 in commercial land with utility service in Irving, Tex. near the Dallas-Ft. Worth airport. Loans in foreclosure process include $490,000 on a Houston tennis club; and $262,000 on commercial property on Houston's north side gradually being reduced by sales. Nonearning investments have been costing the trust about 3¢/share in quarterly earnings, and the two parcels likely to go into development in the next year should reduce this category by about $1.6 million.

Financing: Total debt is 1.3 times shareholders' equity, an extremely low leverage ratio for a short-term construction and development lending trust. The trust borrows under lines of credit from 11 banks under an agreement limiting borrowings to 200% of shareholders' equity (i.e., a 2-to-1 leverage ratio). The trust must maintain a loan portfolio of certain first mortgage loans at least equal to amounts borrowed, and must pledge such loans upon demand of banks holding 51% of debt. The loan agreement is renewable annually in July and has been extended regularly; interest is generally at ¼% over the prime rate and compensating balances of 10% of the line and 10% of amounts borrowed are required. The trust has $2.3 million credit available under the lines.

Management & REIT status: First Continental Mortgage Advisers, Inc., subsidiary of Houston mortgage banker First Continental Corp., serves as adviser for a fee based upon a percentage of invested assets. The trust has maintained status as a qualified REIT continuously since inception in February 1972.

Results & Outlook: Quarterly earnings have been improving since bottoming in the February 1976 quarter and some further improvement is expected over the next year as two large acquired land parcels enter development and start earning income. This could add 2¢ or so to present quarterly earnings of 22¢. But portfolio growth is restricted by the relatively small unused bank lines, and any upturn in short-term interest rates could squeeze spreads on borrowings. The shares are thus attractive for stable to moderately rising income plus some gradual price recovery toward the $10.26/sh. book value. (KDC)

M&T MORTGAGE INVESTORS (9 3/8--OTC--MTMIS) FY Aug. 31

Real estate investments: Funded mortgage investments have been holding in the $40-$42 million range since August 1973 and there's no indication this level of

investments will change significantly anytime soon. The stable investment pattern reflects concentration in Houston and other major Texas housing markets, which have been booming recently from petroleum related business. M&T has concentrated its holdings in these cities because its sponsor and adviser has offices in these cities and thus could monitor investments. Holdings are 56% in Houston, 16% San Antonio, 11% El Paso, 10% Dallas, 3% Austin, 3% Fort Worth, and 1% each in Midland and Corpus Christi, all as of August 1976. This geographic mix will vary depending on relative strength of local housing markets.

By major type, investments of $39.95 million are 64% construction and land development loans predominantly on single-family tracts; 21% are conventional mortgage loans primarily on smaller commercial properties; 5½% are construction and land development loans warehoused for the sponsor and adviser; 4% are FHA-VA permanent loans; 3% property acquired in foreclosure; and 1% second mortgages. By maturity, about 70% are short-term construction and development loans, and about 26% long-term permanent mortgages. By property type, about 74% are single-family construction or development loans and the remainder on various commercial properties (e.g., office buildings, warehouses, shopping centers, restaurants, service stations, etc.). Of the $25.6 million construction and development loans, about $21½ million are for actual construction of homes and the remainder for subdivision development. M&T's construction and development loans require borrowers to make monthly interest payments, in contrast to most other construction loans in which interest is paid through a reserve built into the loan.

A total $1.66 million investments, or 4.1% of the total, are classed as foreclosed property or non-earning loans. Largest acquired properties are: $340,000 in a completed building in Garland, Tex. (near Dallas) suitable for an auto dealership; $400,000 in 17½ acres in Garland suitable for small shopping center development; $230,000 in about 128 lots for single family use in Terrill, Tex. (east of Dallas); several smaller single-family tracts mainly in the Dallas area. Several of these Dallas tracts were planned for the townhouse market but that market dried up and alternative development must be tried. Over the past six years, M&T reports losing $944,000 on its mortgage lending; no losses were recorded in 1971 and 1972, when the trust began business, and losses since that date have averaged 0.58% of monthly balances. Some dispositions of foreclosed properties have been made to the sponsor, such dispositions amounting to $28,000 in FY 1976 and $1,477,000 in FY 1975.

Financing: Total debt is 1.6 times shareholders' equity, a relatively low leverage ratio for a short-term construction lending trust. The trust has pledged mortgage loans approximating $28.5 million as collateral for the demand notes in order to obtain a lower interest rate. Financing has been readily available on this basis. To date the trust has not had to provide compensating balances on borrowings because the sponsor maintains substantial balances in these banks. The sponsor has no legal obligation to provide such balances to benefit the trust, however.

Management & REIT status: The trust is advised by M&T Management Co., subsidiary of Mortgage & Trust, Inc., Houston mortgage banker servicing nearly $1 billion mortgages for distant investors. The adviser receives a percentage of invested assets, subject to limitations, as its fee. Mortgage & Trust and its principal owners have engaged in direct development activities for their own account through joint ventures in the past, and thus a small portion of trust lending is to these entities. The trust has maintained REIT qualification since inception in August 1970.

Results & Outlook: M&T has maintained quarterly dividends at 26¢/sh. for three years, since Nov. 1973, a level down only modestly from the peak 30¢/sh. quarterly payout. Management has flourished by concentrating in single family homes in Texas cities it knows well and can control. Funded investments have remained quite stable over the real estate recession and should continue to do so, despite the housing boom in Texas. M&T shares are very attractive for investors seeking stable, higher quality income and limited price volatility. (KDC)

PROPERTY TRUST OF AMERICA (4--OTC-PTRAS) FY Dec. 31

Real estate investments: On Sept. 30, holdings of $33 million were 23% mortgage loans, 17% mortgage loans foreclosed held for resale and 60% investment properties. The property account includes $3 million acquired by foreclosure held for investment. Most properties were acquired in the early 1970s although the trust was founded earlier. The property mix by gross investment cost is 46% apartments, 20% office buildings, 15% shopping centers, 13% hotel/motel and 5% miscellaneous. Revenues were similarly derived: 83% from rentals consisting of 47% apartments, 7% offices, 10% shopping centers, 16% hotel; 3% other sources; and 13% from interest. Most properties are in Texas. All apartments are in Texas and most were built in the 1960s. The biggest apartment complexes are: $2.6 million Citadel and $2.1 million Apollo-Athena in Houston. Two of the three office buildings are in Texas, the $1.9 million Trust Building in El Paso and the $1.9 million Doctors' Building in Dallas. Shopping centers are in Texas and Colorado, the largest being $1.3 million Southgate in Colorado Springs. The hotel/motel is a $3 million Holiday Inn in San Francisco, Cal. The geographic mix of all holdings was 83% Texas, 8% California and 7% Colorado.

Properties were only marginal performers in 1975 incurring a $57,000 cash flow deficit. The poorest category was apartments with a $699,000 cash flow deficit while office buildings were $189,000 negative. Strongly positive was the hotel, $726,000, and the shopping centers were $128,000 positive. Two of the poorest performing apartment complexes were sold in 1976. This helped achieve the improved cash flow and earnings in 1976. Apartment cash flow was substantially better, the improvement to 90% occupancy at the end of 1975 holding to the 90-95% level during 1976. These apartments cater to lower middle income families and while rentals rose 8-10% in line with the Houston market, expenses often rose similarly. Shopping centers were slightly better. Hotel/motel contribution was off with the sale of a preferred 50% interest in this property. Also in the property category is a $3.5 million, 20-acre tract just north of Houston's Galleria area. This may be the trust's most potentially valuable holding. It is one of the last undeveloped tracts in Houston's hottest area. Studies are underway for a multi-use project on this tract: hotel, office and apartments. Intention is to joint venture with local developers giving the trust a developer's cost instead of open market cost if it had to buy a going project.

The mortgage originated portfolio will ultimately be worked off as present management will not make any mortgage loans. About $5 million earning loans should be repaid in 3-5 years. More uncertain as to disposition are $2.7 million non-earning loans consisting of $1.8 million in an industrial building in El Paso and smaller developments in El Paso. Foreclosed loans of $5 million consist mostly of $2 million of land in northwest Houston which should be sold above cost in 6-12 months and a $1.6 million half-finished shopping center in El Paso now being finished and hopefully leased. Thus the total non-earning and foreclosed category totals $7.7 million, 23% of the entire portfolio. About half of this should be liquidated or on the way to productivity within a year.

Financing: Equity is leveraged 0.8 to 1. Debt of $15 million is all secured mortgages on properties. Bank debt was paid off during the year from property sales and $2.4 million cash was accumulated by Sept. 30.

Management: Trust is self administered by a local El Paso management which came into office two years ago.

Results & outlook: The year was apparently closed out not much differently than the nine months. Operating earnings remained nominal following the 1¢/share for nine months. A property sale in the fourth quarter lost 17¢/share reducing capital gains to 28¢. However, cash flow from the excess of depreciation over amortization was running at a 15¢ annual rate. This together with the capital gains from property sales provided adequate coverage for the renewed quarterly dividend, 5¢ for the last three quarters. Although properties are obviously marginal, there could be further improvement. Moreover, being viable and standard property types, they are readily salable. If the poorest were sold around depreciated book value or better, the bulk could be disposed of if necessary. There is $2 million free cash for new investment.

Management is looking in Houston, San Antonio and Dallas at $2-3 million deals which require up to $500-600,000 equity. It does not want to go higher in order to preserve diversity. Neighborhood shopping centers and net lease office buildings are sought but few good properties are around.

Having just defeated a tender offer at $4/share from Hunt Building Corp., a Texas construction firm, market interest is greater for the shares. The situation is certainly viable with a few properties providing the cornerstone of a decent portfolio. With no debt other than secured mortgages, this is one of the cleanest trust balance sheets. Given the expected workdown of problem loans and land conversion, the portfolio could be over 80% equity in about a year. Further upgrading of the portfolio is necessary to provide greater value than current quotes but upside possiblity exists at nearly 50% below book value of $7.72. (BS)

BAIRD & WARNER MORTGAGE AND REALTY INVESTORS (7--OTC-BAIDS) FY July 31

Real estate investments: On Oct. 31, holdings of $42 million were 65% mortgages and 35% deliberately acquired properties. By property type, funded mortgages and commitments were: 32% industrial, 17% condominiums, 15% apartments, 12% land, 11% shopping centers, 6% office buildings and 7% other. Over 83% of all holdings are in the midwest centered around the home base of Chicago. The property portfolio consists of 86% income properties (depreciated), 8% land leasebacks and 5% partnerships. These equities are fairly basic real estate and include a $2.9 million office building near O'Hare Airport outside Chicago, a $1.4 million shopping center (containing Kroger and Super X adjoining a Sears) in Green Bay, Wis., and $1.6 million in two apartment partnerships, Glen Ellyn (now wholly owned) and Chicago, both in Illinois.

One of the few trusts making new commitments, Baird has $14 million unfunded commitments. These are being funded fairly fast, indicating a good portion will be funded within the year. Paydowns will continue, but at a slow pace, indicating the mortgage portfolio will rise slightly. Commitments are only being made in its midwestern locale. Long-term takeouts are being required on new construction loans while land and condominium projects will not be considered. Most loans are being made at the traditional construction lending rate of 3% over prime rate. The current philosophy is to avoid the marginal 25% of construction loan categories, land and condos, where the trust encountered most of its problems.

A total $14.2 million, 33.7% of the portfolio, was non-earning or troubled at October 1976. Of this, $10.3 million was in non-accruing loans attributable $1.7 million in five land loans, $3.4 million in two condominium loans, $2 million on an office building and $3.1 million on an apartment. The land loans will require an indefinite holding period, at least a few years. Some of the condos are being sold this year but it will take two-three years to sell out completely. The industrial building and the apartment should be disposed of within a year.

Financing: Equity of $17 million is leveraged 1.3, a conservative ratio for a mortgage lending trust. Total funds of $40 million are 24% short-term debt, 22% secured mortgages on properties, 10% convertible debentures and 44% equity (which consists of 1,042,887 shares with book value of $16.67/share). Interest on the bank lines is ¼% over the prime rate plus either 15% compensating balances or 10% of the line and 10% of funds drawn. Funds drawn will increase by rising commitment fundings.

Management: Baird & Warner Co., Chicago mortgage banker also qualified to act as property manager and contractor for the trust.

Results & outlook: Earnings in the October quarter, first of the fiscal year, were 13¢/share after 9¢ loss provision. The trust is currently paying quarterly dividends of 24¢ through fiscal 1977 out of taxable 1976 earnings. Future reported earnings could exceed taxable earnings as collections are made.

Future operations should show stability to modest improvement. Non-earning investments appear to be leveling. Renewed short-term lending should be positive. The trust is dealing in traditional areas in its home territory. Back-up from the sponsor provides a full range of capabilities: property management for all types of standard properties, leasing and brokerage. Although perhaps only a medium grade situation, further recovery of the shares selling over 50% below book value seems warranted. A fair, if uncertain, return is also provided. (BS)